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**DEPARTMENT OF JUSTICE**



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June 22, 2001

Paul G. Smith, Esq.  
General Counsel  
California State Library  
Library Courts Building  
P.O. Box 942837  
Sacramento, CA 94237-0001

RE: Leases and the California Public Library Construction and Renovation Bond Act of 2000.

Dear Mr. Smith:

This letter provides an informal opinion regarding whether or not an applicant is required to own the land upon which a library facility will be constructed or rehabilitated in order to be an eligible grant recipient under the California Reading and Literacy Improvement and Public Library Construction and Renovation Bond Act of 2000 (Library Bond Act or Bond Act).

#### **ISSUES PRESENTED**

Does the applicant have to own the land in fee simple for a project to be funded with Library Bond Act funds or may an applicant lease the land for such a project?

#### **SHORT ANSWER**

The applicant need not own the land in fee simple for a project to be funded with Library Bond Act funds, but the applicant needs to have the equivalent of fee ownership in the land. In addition, significant restrictions would be required on any lease entered into to by an applicant in order to qualify for such funds.

#### **BACKGROUND**

The Library Bond Act provides for the issuance of State of California General Obligation Bonds in the amount of \$350 million dollars.<sup>1</sup> The money raised from the Bond Act is intended to

<sup>1</sup> Ed. Code § 20000.

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provide grants to cities, counties, a city and county, or districts that are authorized at the time of the project application to own and maintain a public library facility.<sup>2</sup>

The Bond Act does not specifically state that a project proposed to be built with bond proceeds cannot be constructed on leased land, nor does the Bond Act specifically prohibit it. However, the Bond Act does state that bond proceeds are available for grants to cities, counties, cities and counties, or districts that are "authorized at the time of project application to *own and maintain* a public library facility..." (emphasis added).<sup>3</sup> In addition, the Bond Act requires that a facility for which grant money was received must be dedicated to public library direct service use for a period of not less than 20 years following completion of the project.<sup>4</sup> The Bond Act further provides that if the building ceases to be used in such a manner, the California Public Library Construction and Renovation Board ("Board") may recover monies in a suit filed in superior court.<sup>5</sup> Additionally, the Bond Act requires that funds that are received by a recipient be expended only in connection with public library facilities.<sup>6</sup> Lastly, applications are required to be for library facility projects.<sup>7</sup> Thus, it is clear from the statutes that Library Bond Act bond funds are only to be used in connection with public library facilities, by entities authorized to own and maintain such facilities, and that these facilities are expected to be used for public library purposes for not less than 20 years after the completion of the project.

Additionally, the Bond Act makes clear that the interest or other carrying charges for financing the project are neither a proper use of grant money nor may such be counted as part of the required matching funds provided by the grant recipient.<sup>8</sup> These carrying charges include, but are not limited to, costs of loans or lease-purchase agreements in excess of the direct costs of any of the authorized purposes specified in Education Code section 19989.<sup>9</sup> In turn the applicable portion of section 19989 states that grant funds and matching funds shall be used by the recipient for the acquisition of land necessary for the purpose of acquisition or construction of new facilities or additions to existing public library facilities.<sup>10</sup>

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<sup>2</sup> Ed. Code §19988.

<sup>3</sup> Ed. Code §19988.

<sup>4</sup> Ed. Code § 19999(a).

<sup>5</sup> Ed. Code §19999(c).

<sup>6</sup> Ed. Code § 19989.

<sup>7</sup> Ed. Code § 19993(a).

<sup>8</sup> Ed. Code § 19990.

<sup>9</sup> Id.

<sup>10</sup> Ed. Code § 19989.

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### ANALYSIS

As stated above, Education Code section 19988 requires applicants to be authorized to own and maintain the public library facility. In addition, Education Code section 19999(a) requires bond-funded library facilities to be dedicated to library use for not less than 20 years. Therefore, the applicant would, at least, need to be able to show indicia of site control tantamount to ownership for not less than 20 years. Typically site control is demonstrated by fee simple ownership. The classic example of a lease term that would be tantamount to ownership is a 99-year lease. It may be possible for a lease to be structured in such a way that the applicant has complete site control that would be tantamount to ownership for a period of less than 99 years, but it is unlikely a 20 year term would qualify.

In addition, to a lengthy term of years, at a minimum, the lease would have to be structured in a such a way so the title holder has no remedy of eviction. This may require either the rent to either be fully paid in advance or for the title holder to agree to only proceed for money damages in the case of unpaid rent. Further, the lease would need to be structured so that there is not a threat that a forfeiture of the land could occur by, for example, failure by the title holder to pay taxes or other debts. Therefore, if a lease is being used, it would in effect have to be the equivalent of fee simple ownership. This might be able to be accomplished with a "net-net lease" or perhaps by having the lease qualify as a transfer under California state tax law but without having the actual title transfer. Please note that without an examination of the leases in question it is not possible to determine if any given lease meets the requirements imposed by the Bond Act.

Moreover, buildings have a useful life well in excess of 20 years. For example, the Internal Revenue Service allows depreciation of non-residential buildings over a 39 year period.<sup>11</sup> This implies non-residential buildings have a useful life of at least 39 years according to the IRS. When improvements are made to real estate that are attached to the land, those improvements stay with the landlord when the tenant vacates the premises. So at the end of the lease term, the building built with Bond Act proceeds would belong to the landlord. The potential exists for a fully operational building to be forfeited to the landlord with significant useful life remaining.

### Other Issues

Please be advised that additional issues, which are not addressed by this memorandum, are raised if the Board decides to permit applicants who are leasing the land for their project obtain grant funding. For example, the tax consequences on the bonds of making lease payments to title holder or other non-local governmental entities may need to be examined. Similarly, since bond funds and matching local money may only be used for library facilities, the lease and the plans

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<sup>11</sup> Department of the Treasury Internal Revenue Service Form 4562 (2000), Item 15(i).

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would have to be reviewed to make certain that only library facilities, and not facilities owned by the title holder, were being improved. Additionally, since lease costs would not be eligible costs for grant funds or matching funds, concerns regarding the lease costs may need to be considered in determining the financial capacity of the local agency submitting the application. The issue of the financial capacity would also need to be examined if, for tax-purposes, ownership is not held by the local agency and the local agency is required by the terms of the lease to pay property taxes and other fees or assessments attached to the land. Lastly, as a practical consideration, the Board may want to make a determination of the ability to obtain reimbursement from the applicant through a lawsuit authorized by Education Code section 19999(c). This last point may be advisable given increased complexity and thus risk, that a lease property may end up not being used as a library facility for a minimum of 20 years after completion of the project.

The preceding paragraph was not an exhaustive list of all additional issues that will need to be addressed if applicants of lease properties are considered eligible for grant under the Library Act, the paragraph simply raises some of the issues known to exist at this point.

### CONCLUSION

The Library Bond Act specifically requires the project applicant to be authorized to own the land in order to qualify for a grant. Although it is possible for a lease to be structured to give the project applicant the equivalent of fee ownership in the land, several requirements of state law, and the Bond Act are clearly implicated by the status of land ownership.<sup>12</sup> Therefore, any applicant who does not own the land upon which the library facility is or is to be located would have to be able to meet those requirements in order to qualify for a grant under the Library Bond Act. Each situation would need to be evaluated by the Attorney General's Office and bond counsel on a case-by-case basis.

If you have any questions or concerns, please call me at (916) 445-6998.

Sincerely,



Jennifer K. Rockwell  
Deputy Attorney General

For BILL LOCKYER  
Attorney General

<sup>12</sup> Please note, federal tax law are beyond the scope of this letter.